DIRECTOR-GENERAL OF INLAND REVENUE

v.

HARRISONS & CROSFIELD (M) SDN. BHD.

SUPREME COURT, KUALA LUMPUR
GEORGE SEAH SCJ
HASHIM YEOP SANI SCJ
SYED AGIL BARAKBAH SCJ
[CIVIL APPEAL NO. 34 OF 1987]
24 APRIL 1988

REVENUE LAW: *Income Tax - Payment of additional remuneration - Contractual term - Payment contingent on profit made and rate reviewable by employer - Whether payment was in addition to usual remuneration - Whether payment was a bonus - Test to be applied.*

This was an appeal against the decision of the High Court which held that the additional remuneration under the additional remuneration scheme of the respondent company was not a bonus for the purpose of s. 39(1)(h) Income Tax Act. The senior executives and managerial staff were paid a monthly salary which included the additional remuneration. The respondent contended that the additional remuneration was not a bonus and it was a contractual term. In the letter of appointment, the characteristics of the additional remuneration were the senior executives were entitled to participate in the profit of the company but the participation was subject to review by the company annually; the payment was separate and distinct from the fixed salary; the fixed salary and additional remuneration constituted the total remuneration; and the company reserved the right to review individual rates.

Held:

[1] There was no definition of the term "bonus" in the Income Tax Act. A payment could be a bonus even if it was a contractual term. It depended on the nature and character of the payment. The label which was used to describe the payment is not conclusive. The test which was applied was whether it was something in addition to in excess of what was ordinarily received.

[2] The additional remuneration was a bonus as it was separate and distinct from the fixed salary; it was payable upon the respondent company making a profit; and the rate was reviewable by the employer.

Cases referred to:

Shelford v. Mosey [1917] 1 KB 154
Sutton v. A.G. [1923] 39 TLR 294
Re Eddystone Marine Insurance [1894] WN 30
Commissioners of Inland Revenue v. Wesleyan and General Assurance Society 30 TC 11
Great Western Garment Co. v. Minister of National Revenue [1948] 1 DLR 225

Legislation referred to:

Income Tax Act 1967, ss. 33, 39(1)(h)

For the appellant - Abdul Hamid bin Haji Mohamed, SFC
For the respondent - Michael K.L. Wong (P.H. Yeo with him); M/s. Shook, Lin & Bok

JUDGMENT

Hashim Yeop Sani SCJ:

The appeal before the learned Judge (Harun J) was by way of case stated against the majority decision of the Special Commissioners of Income Tax. The question before the Commissioners was whether the payment of the additional remuneration (AR) under the additional remuneration scheme of the respondent company was bonus for the purposes of s. 39(1)(h) of the Income Tax Act. The Special Commissioners by majority decided in favour of revenue. Harun J however disagreed and allowed the appeal. Hence the appeal before us.

The senior executives and managerial staff of the respondent company were paid a monthly salary which included the AR in question. By virtue of s. 33 of the Income Tax Act all outgoings and expenses wholly and exclusively incurred in the production of gross income is deductible. However by virtue of s. 39(1)(h) of the Act ("deductions not allowed") if the sum paid to the employees in bonus, then not all such payment is deductible even though the amount is wholly and exclusively incurred for the production of income. As a result of the amendment to s. 39(1)(h) of the Act in 1975 (Act A237 of 1975) no deduction from the gross income would be allowed in respect of any sum paid as bonus in excess of 2/12 of the employee's wages or salary.

In this case revenue had disallowed deduction in excess of 2/12 of the employee's wages and salaries in respect of the AR. It is thus important for revenue to be certain whether to classify the AR as "bonus", or as contended by the respondent company as "commission" or "deferred salary" for the purpose of applying s. 39(1)(h) of the Income Tax Act.

The respondent company is a company incorporated in Malaysia. According to the primary facts as found by the Special Commissioners the AR paid to the senior executives and managerial staff of the company was paid under the Additional Remuneration Scheme formulated in 1935 which rules were revised in 1962. When the senior executive was first employed he would receive a "fixed salary" and the AR under the scheme and this is so stated in his letter of appointment. According to the procedure followed by the respondent company when the senior executive's tour of service was extended his level of the AR would be negotiated between him and the company. The amount agreed would be added to his increased "fixed salary" and the total would be shown in his contract of employment. It was also agreed that the "market value" of each senior executive would comprise his basic salary and in addition his AR. The AR was based upon a percentage of the combined audited profits of the respondent company. Negotiation as to the rate under the additional remuneration scheme with each expatriate senior executive was done in London during his leave after his tour of service and as regard the local senior executive negotiation was done by correspondence with the London office of the company. For the year of assessment in question (1975) there were out of 450 executives of the company only 21 (20 expatriates and 1 local) senior executives who were paid under the Additional Remuneration Scheme.

In respect of the junior executives of the respondent company instead of receiving payment under the Additional Remuneration Scheme referred to they together with the non-managerial staff were paid bonus at the discretion of the respondent company. However after four years of service the expatriates who had served as junior executives for four years would be entitled to participate in the Additional Remuneration Scheme. It was the practice of the company to pay the junior executives and the non-managerial staff an annual bonus of two months salary.

The senior executives participating under the Additional Remuneration Scheme were not eligible to receive bonus paid to the junior executives and the non-managerial staff. They were not allowed to opt for the said bonus instead of the AR and neither were they allowed to receive a higher basic salary without the AR.

The respondent company is not disputing that they were paying bonus to the junior executives and the non-managerial staff. What the company is contending is that the AR paid to the senior executives is not bonus but should be regarded as either commission that or deferred salary. The contention that the AR is not bonus is based primarily on the fact the payment of the AR is contained in the letter of appointment of the senior executives and therefore contractual. This was the argument which attracted the learned Judge in the Court below and which formed the crux of his judgment. The learned Judge in his judgment (p. 11) said that it would be a contradiction in terms to speak of contractual bonus because bonus by definition is gratuitous. He then ruled that:

> In the context of s. 39(1)(h) I am of the view that a distinctive feature that remuneration is not a bonus is if the payment is contractual.

The learned Judge found that the AR was a contractual payment and formed a distinct component of the senior executives remuneration.

The question whether a payment if contractual cannot be bonus was also posed to the Supreme Court in *Highlands Malaya Plantations Ltd. v. Director General of Inland Revenue* Supreme Court Civil Appeal No. 13 of 1987. That appeal was also against the decision of the same Judge in another appeal by way of case stated where the main issue was whether the additional remuneration paid to the managerial staff of a company under the group bonus scheme was bonus under s. 39(1)(h) of the Income Tax Act. The question was whether the payment being contractual can be regarded as a bonus. There the Special Commissioners held that such contractual payment can be bonus but the learned Judge disagreed. The Special Commissioners relied on *Shelford v. Mosey* [1917] 1 KB 154 where the bonus payment was clearly contractual, and *Sutton v. A.G.* [1923] 39 TLR 294 where Lord Birkenhead stated that the term "bonus" may of course properly be used to describe payments made of grace and not as of right but it nevertheless may also include payments made because legally due but which the parties contemplate will not continue indefinitely.

We hold the same view that a payment can be a bonus even if contractual. It all depends on the nature or character of the payment. In Highlands the company there used the word “bonus” to describe the payment in their correspondence. In the appeal before us however the respondent company never used the word “bonus” except in respect of payment to the junior executives and the non-managerial staff. The Income Tax Act does not define the word “bonus”. This elusive question was dealt with succintly by Lee Hun Hoe CJ (Borneo) in the judgment of the Supreme Court in Highlands as follows:

> It is difficult to lay down any general rule as to what “bonus” is. Jowitt’s *Dictionary on English Law*, 2nd Edn., Vol. 1 at p. 238 defines “bonus” to mean premium or advantage; an occasional extra dividend; a gratuity. The Income Tax Act, 1967 does not define the word “bonus”. Both the learned Judge and the Special Commissioners accepted “bonus” to mean “a boon or gift over and above what is normally due as remuneration to the receiver.” They were merely following what Stirling J did in *Re Eddystone Marine Insurance* [1894] WN 30 when he said:
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> > I adopt the definition of ‘bonus’ given in the *New English Dictionary*, viz., ‘a boon or gift over and above what is normally due as remuneration to the receiver, and which is therefore something wholly to the good.

We are not unmindful that the label itself is not conclusive. Thus in *Commissioners of Inland Revenue v. Wesleyan And General Assurance Society* 30 TC 11 the taxpayer sought to call an annuity a loan while the revenue contended that it was an annuity and not a loan. The House of Lords decided that it was an annuity. At p. 25 Viscount Simon made the following observation:

> It may be well to repeat two propositions which are well established in the application of the law relating to Income Tax. First, the name given to a transaction by the parties concerned does not necessarily decide the nature of the transaction. To call a payment a loan if it is really an annuity does not assist the taxpayer, any more than to call an item a capital payment would prevent it from being regarded as an income payment if that is its true nature. The question always is what is the real character of the payment, not what the parties call it.

To determine whether a payment is bonus we have to go behind the label and seek its true character. To determine the character of the AR it would be useful to begin with the sample of the letter of appointment of the senior executives of the respondent company and this appears at pp. 125 - 126 of the appeal record. The salary and additional remuneration scheme are described in the letter of appointment as follows:

Salary:	At the rate of RM2,100 per month. This salary includes an amount of RM400 per month consolidated from the Additional Remuneration Scheme. (Please see below).
...	
Additional Remuneration Scheme:	You would be entitled to participate in profits under the rules of the additional remuneration scheme at the rate of ¼% of the adjusted net profits of Harrisons & Crosfield (Malaysia) Sdn. Bhd. The basis of participation of the staff as a whole is subject to review annually at 30 June and we must reserve the right to review individual rates at the same time. The amount of RM400 per month consolidated into basic salary is deductible from any amount of ARS becoming due for payment.

Rule 5(a) and (c) of the rules of the scheme for additional remuneration (pp. 91 and 92 of the appeal record) reads as follows:

> (a) The additional remuneration due to a recipient shall be a sum equivalent to a percentage of the profits of the department, branch, or associated company in which he is engaged, as shown by the profit and loss accounts forwarded to Harrisons & Crosfield, Limited, in London, adjusted in accordance with rule 7. Such percentage shall be either a flat rate or a rate based on a datum line of profits, in which latter case additional remuneration is respect of profits in excess of such datum line shall be paid at a higher rate or lower that in respect of those up to that line. Provided that the additional remuneration payable shall in the case of every recipient be limited to such an amount as the appropriate revenue authorities shall allow as a deduction from such profits for the purpose of any taxation levied in respect of such profits in any part of the world.
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> (c) Although the additional remuneration provided for under this scheme is equal to a percentage of the profits of the department, branch, or asssociated company concerned, the amount shall be paid to each individual as remuneration for services rendered by him outside the United Kingdom, and his fixed salary and additional remuneration under this scheme shall together form his total remuneration for the Company's year in which the amounts are paid.

The following characteristics of the AR are revealed from the letter of appointment and the Rules:

(1) The senior executives are entitled to participate in the profits of the company under the AR scheme.

(2) The basis of participation is however subject to review by the company annually.

(3) The AR is separate and distinct from the "fixed salary" of the senior executives.

(4) The fixed salary and AR constitute the total remuneration.

(5) The company reserved the right to review individual rates.

In *Re Eddystone Marine Insurance* (not a tax case) Stirling J adopted the definition of "bonus" given in the New English Dictionary viz. "a boon or gift over and above what is normally due as remuneration.' In *Great Western Garment Co. v. Minister of National Revenue* [1948] 1 DLR 225 to ascertain whether payment was a bonus O'Connor J applied the test whether it is something in addition to or in excess of what is ordinarily received. He then held that in the context of that case where a company passed a resolution providing for certain officials' salaries to be free of income tax, the "free of income tax" is not something in addition to or in excess of what is to be received but part and parcel of a salary.

Therefore although the market value of each senior executive of the respondent company would comprise his basic salary and in addition his AR the character of the AR makes it separate and distinct from the fixed salary and therefore cannot be regarded as a deferred salary. Secondly, although the Additional Remuneration Scheme is a permanent scheme and under the rules the payment of AR itself is in that sense permanent the AR was payable contingent upon the respondent company making a profit. Finally the rate of AR is reviewable by the employer which the employer is not permitted to do with respect to the salary.

The senior executives were paid AR and the junior executives and the non-managerial staff were paid bonus based on profitability. The AR therefore is nothing more than a bonus and should be regarded in law as a bonus by a different name. The senior executives are not entitled to the AR and the junior executives and the non-managerial staff are not entitled to bonus if the company does not make a profit.

The question posed is therefore a narrow one whether AR is a bonus in character although it is called AR and not bonus. Our answer is that it is bonus and caught by s. 39(1)(h) of the Income Tax Act.

The appeal is accordingly allowed with costs.

Also found at [1988] 2 CLJ 1